Federal Accounting Standards Advisory Board

August 3, 2003

TO: Members of FASAB

FROM: Robert Bramlett

THROUGH: Wendy Comes, Executive Director, FASAB

SUBJECT: Objectives of Federal Financial Reporting—additional background information

NOTE: FASAB staff prepares memos and other materials to facilitate discussion of issues at Board meetings. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

Introduction

The Board has been discussing the objectives of federal financial reporting and the possible impact of new laws and other developments since SFFAC 1 was published. Board members have requested additional background information on several topics. This memo offers some comments and observations from my perspective and transmits additional background information as follows:

This is provided as general background information. Staff does not expect to ask the Board to make definite decisions regarding objectives at the August meeting, but some possible issues for discussion are listed on page 44.

Selected laws and guidance affecting federal financial management, internal control, and financial reporting (a partial list)

This list also includes some laws of special significance that apply to private sector entities.

Budget and Accounting Procedures Act of 1950

Among other things, this gave GAO authority to set accounting standards for the federal government and indicated that GAO audits should be directed at determining to the extent to which adequate internal financial control is exercised. Requires the head of each agency to establish and maintain systems of accounting and internal control designed to provide, among other things, effective control over and accountability for all funds, property, and other assets. States that GAO audits shall consider the effectiveness of accounting organizations and systems, internal audit and control, and related administrative practices.

A substantial portion of the general guidance issued by GAO to executive agencies was first codified into the GAO *Policy and Procedures Manual for Guidance of Federal Agencies* in 1957. The accounting standards issued by GAO were published as "title 2" of that manual. Over the years the manual was updated to incorporate current changes in laws, regulations, and practices. However, in recent years changes in certain laws; the creation of the Federal Accounting Standards Advisory Board (FASAB); the establishment of the Advisory Council on Government Auditing Standards; and the different vehicles GAO has used to publish guidance (e.g. the Yellow Book and the Green Book on internal control standards) have led to changes. For details on those changes, and for other GAO guidance on financial management, see "Other Publications," then "Accounting and Financial Management" and "Government Policy and Guidance" at www.gao.gov

Foreign Corrupt Practices Act of 1977 (FCPA)

This law was passed partly in response to findings of the Watergate Special Prosecutor. It requires SEC registrants to devise and maintain a system of internal accounting control sufficient to provide reasonable assurance that (1) transactions are executed in accordance with management's general or specific authorization, (2) transactions are recorded as necessary to maintain accountability for assets, (3) access to assets is permitted only in accordance with management's general or specific authorization, and (4) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

Federal Managers' Financial Integrity Act of 1982 (FMFIA)

(Amended by the Federal Reports Elimination and Sunset Act of 1995)

Requires GAO to prescribe standards of internal accounting and administrative control and agencies to comply with them. Internal control is to provide reasonable assurance that (1) obligations and costs comply with applicable law (2) assets are safeguarded against waste, loss, unauthorized use, or misappropriation, and (3) revenues and expenditures are recorded and accounted for properly so that accounts and financial and statistical reports may be prepared and the accountability of assets may be maintained.

Requires that the internal control standards include standards to ensure the prompt resolution of all audit findings. Requires OMB to establish guidelines for agency evaluation of internal control to determine compliance with the internal control standards.

Requires agency heads to (1) annually evaluate their internal control using the OMB guidelines, and (2) annually report on whether the agency's internal controls comply with the standards and objectives set forth in the Act. If they do not fully comply, the report must identify the weaknesses and describe plans for correction. The report is to be signed by the head of the agency. The Inspector General is to report on the Agency Head's report.

Single Audit Act of 1984

(Amended by the Single Audit Act Amendments of 1996)

Requires that audits of state or local governments receiving federal financial assistance over specified amounts shall determine and report whether the governmental entity has internal control systems to provide reasonable assurance that it is managing federal financial assistance programs in compliance with applicable laws and regulations.

If the audit finds any material weakness in the internal control, the state or local governmental entity shall submit a plan for corrections to eliminate such weakness or a statement describing the reasons that correction is not necessary. Such plan shall be consistent with the audit resolution standard promulgated by GAO.

Chief Financial Officers Act of 1990 (CFO Act)

(Amended by the Government Management Reform Act)

States that the purposes of the Act are to ensure improvement in agency systems of accounting, financial management, and internal control; to assure the issuance of reliable financial information; and to deter fraud, waste, and abuse of government resources. Requires preparation of annual audited financial statements in conformity with "applicable standards." Initially this requirement applied to trust funds, revolving funds, commercial type activities, and 10 pilot agencies. The requirement was extended to all major agencies and departments by the GMRA (see below).

Requires that agency CFOs develop and maintain integrated agency accounting and financial management systems, including financial reporting and internal control. Requires agency CFOs to prepare and transmit an annual report to the agency head and the Director of OMB including a summary of the reports on internal accounting and administrative control systems submitted to the President and Congress under the FMFIA.

Federal Deposit Insurance Corporation Improvement Act of 1991
(FDICIA)

This law was passed in part in response to the "saving and loan" crisis. It requires that insured depository institutions with assets above a threshold set by the FDIC prepare an annual report containing a statement of management's responsibilities for establishing and maintaining an adequate internal control structure. The report must contain an assessment of the effectiveness of the internal control structure and procedures.

Requires that the institution's independent public accountant attest to and report separately on the assertions made by management.

Government Performance and Results Act of 1993
(GPRA)

The Act requires agencies to prepare strategic plans, annual performance plans, and annual performance reports. For more details, see the enclosed articles. As noted below, the Reports Consolidation Act of 2000 allows an agency to combine its audited financial statement, as required by the CFO Act, and its performance reports, as required by the GPRA to provide a more comprehensive and useful picture of the services provided. OMB now requires agencies to consolidate their audited financial statements and other financial and performance reports into combined Performance and Accountability Reports.

Government Management Reform Act of 1994
(GMRA)

This extended the requirements of the CFO Act to all accounts and associated activities of each office, bureau, and activity for all 24 CFO Act agencies. The Act also required preparation and audit of consolidated, government wide statements covering all executive branch agencies.

Federal Financial Management Improvement Act of 1996
(FFMIA)

Requires each agency to implement and maintain financial management systems that can comply substantially with:

1. System requirements

2. Applicable federal accounting standards

3. The Standard General Ledger. For the SGL, the Treasury Financial Manual, and other guidance, see http://www.fms.treas.gov/

Requires that each agency's annual audit report state whether the agency's financial management systems comply with the requirements.

OMB Circular A-123 (revised)
Management Accountability and Control

Provides guidance on establishing, assessing, correcting and reporting on management control. Essentially this is OMB guidance pursuant to FMFIA. For more on this and other OMB guidance see http://www.whitehouse.gov/omb/financial/index.html

OMB Circular A-127
Financial Management Systems

Prescribes policies and standards to follow in developing, operating, evaluating, and reporting on financial management systems including internal control.

JFMIP Framework for Federal Financial Management Systems

Describes the framework for establishing and maintaining federal financial management systems and explains what is meant by a single, integrated agency financial management system. For more on JFMIP guidance see http://www.jfmip.gov/jfmip/

GAO Standards for Internal Control in the Federal Government

Originally promulgated pursuant to the 1950 Budget and Accounting Procedures Act, this was updated in 1998 to be consistent with the *Internal Control Integrated Framework* published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). (For more on COSO, see www.coso.org). For GAO standards, and other GAO guidance on financial management, go to "Other Publications," then click on "Accounting and Financial Management" and on "Government Policy and Guidance" at www.gao.gov

Reports Consolidation Act of 2000

This Act builds on a pilot program authorized in 1994. Allows an agency to combine its audited financial statement, as required by the CFO Act, and its performance reports, required by the GPRA to provide a more comprehensive and useful picture of the services provided. More specifically, the Act authorizes the head of an agency to (1) adjust the frequency and due dates of, and consolidate into an annual report to the President, Director of OMB, and Congress, certain statutorily required reports (including financial and performance management reports) and (2) submit such a consolidated report not later than 150 days after the end of the agency's fiscal year.

Requires such a consolidated report: (1) that incorporates the agency's program performance report to be referred to as a **Performance and Accountability Report**; (2) that does not incorporate the agency's program performance report to contain a summary of the most significant portions, including the agency's success in achieving key performance goals; (3) to include a statement by the agency's inspector general that summarizes the agency's most serious management and performance challenges; and (4) to include a transmittal letter from the agency head containing an assessment of the completeness and reliability of the performance and financial data used in the report.

Amends provisions related to financial statements of Federal agencies to (1) require the agency head to submit audited financial statements covering the agency's overall financial position and operations; and (2) repeal submission requirements for certain other such statements.

Amends provisions related to program performance reports to require that each such report contain a completeness and reliability assessment, unless such a report is incorporated into a consolidated report.

Accountability of Tax Dollars Act of 2002

Requires annual audited financial statements from most executive branch agencies not previously required to prepare and submit such reports. OMB may exempt agencies with budgets under $25 million in a given year. The newly covered agencies will be subject to OMB Bulletin 01-09, Form and Content of Agency Financial Statements, beginning with FY 2003. This bulletin requires agencies to consolidate their audited financial statements and other financial and performance reports into combined Performance and Accountability Reports and accelerates the deadline for submission.

Improper Payments Information Act of 2002

Requires federal agencies to identify programs vulnerable to improper payments and to estimate annually the amount of underpayments and overpayments made by these programs.

Sarbanes-Oxley Act of 2002 (SOX)

This Act contains numerous provisions affecting publicly owned companies and public accountants. Of particular interest in this context is Section 404, "Management Assessment of Internal Controls"

> **Section 404: Management Assessment Of Internal Controls.**
>
> Requires each annual report of an issuer to contain an "internal control report", which shall:
>
> (1) State the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and
>
> (2) Contain an assessment, as of the end of the issuer's fiscal year, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting.
>
> Each issuer's auditor shall attest to, and report on, the assessment made by the management of the issuer. An attestation made under this section shall be in accordance with standards for attestation engagements issued or adopted by the Board. An attestation engagement shall not be the subject of a separate engagement.

This list does not include numerous other laws and sources of guidance relevant to financial management, financial and information systems, and control systems, including Federal Appropriation Law, the Prompt Payment Act, Comptroller General Decisions, the Government Information Security Reform provisions of the National Defense Authorization Act for 2001 (GISRA), the Federal Information Security Management Act of 2002 (FISMA), etc.

For more on major laws of interest to FASAB, see:

CRS Report for Congress *Financial Management in the Federal Government: Efforts to Improve Performance*, by Virginia McMurtry, June 17, 2003

Reporting on internal control

Internal control in general, and in relation to financial statement audits, is a complex topic with an extensive literature. This paper does not purport to give an in-depth discussion, or even a comprehensive overview. If the Board were to decide to undertake a project on internal control, a good deal more research and exposition would be essential.

In the federal government

FMFIA required comprehensive reporting on internal control two decades before audited financial statements were required from most agencies. These requirements remain in effect. They are not necessarily equivalent to reporting on controls over financial reporting. The scope of controls contemplated by FMFIA would seem to be broader, focusing on operational and legal compliance issues. Furthermore, judgments about materiality may be different as well.

To complicate matters, the auditor must report on compliance with FFMIA, including compliance with systems requirements, accounting standards and the SGL. There may be control implications in assessing these matters. Some have argued that compliance for this purpose (e.g., with SFFAS 4) may imply something different than conformance with GAAP for the purpose of expressing an opinion on financial statements. That is, some would say that an agency might be able to publish financial statements in conformance with GAAP, but not be in compliance with SFFAS 4 for purposes of FFMIA.

Yet another nuance arises from the difference (at least until recently) between requirements of AICPA's GAAS and GAO's Government Audit Standards (the Yellow Book) regarding the auditor's responsibility to report on internal control. GAO required auditors to report on control when conducting audits in accordance with the Yellow Book. This report did not rise to the level of positive assurance on the controls *per se*.

Unfortunately, I am not aware of a comprehensive review of the evolution and current status of internal control reporting requirements and issues in the federal government, and did not have time to write one for this meeting. I have been told that GAO staff may prepare such a paper for the Comptroller General's Advisory Council on Government Audit Standards. Absent such an overview, it is necessary to cite several sources:

1. The Financial Audit Manual published by GAO and the PCIE discusses internal control in connection with financial audits at http://www.gao.gov/special.pubs/01765G/. See sections

300 and 700 on internal control. Section 500 deals with reporting, including some references to internal control.

2. GAO has also published Federal Information System Controls Audit Manual: Volume I Financial Statement Audits, June 2001, available at AIMD-12.19.6

3. OMB provides guidance on internal control in connection with FFMIA in

- Federal Managers Financial Integrity Act (Integrity Act) of 1982 (P.L. 97-255)
    - Revised Implementation Guidance for the Federal Financial Management Improvement Act (January 4, 2001)

OMB also provides guidance regarding FFMIA in:

- OMB Circular A-123, Management Accountability and Control (June 21, 1995)
- OMB Circular A-127, Financial Management Systems (July 23, 1993)

For more on FMFIA, see the enclosed article by "The Maturing of the Management Control Process," by William Kendig, from *The Govenrment Accountants Journal* for Spring 1992.

In the private sector

As with the federal sector, there have been two perspectives on internal control in private organizations. One, the purview of managers and internal auditors, focused on operational and compliance issues. The other, largely under the purview of the independent public accountant focused on controls relevant to financial reporting.

Governments at all levels have long imposed some requirements for record keeping, in order to administer tax, security, and other laws. During the past generation, the FCPA of 1977 was initially perceived as a significant new requirement of this sort. The law was passed in response to concerns about corruption of the political process as well as in corporate governance in the U.S. and overseas. The law was not just about internal control and accounting to support financial reporting. Society had interests in corporate accounting and accountability that went deeper.

Although there have been some prosecutions for violations of FCPA, it turned out to have little direct impact on independent public accountants. It did not lead to the IPA attesting to corporate management's report on control. In 1991, FDICIA mandated just that for federally insured depository institutions. And it appears that in 2002 SOX has mandated that for all publicly traded corporations. (Last week the PCAOB conducted a public “roundtable” on this topic. It seems that some details regarding the responsibility of management and the IPA under the new law remain at issue. For more details, including an audio recording of the session, see www.pcaobus.org).

References to objectives in SFFAC 2 and SFFAS 1-8

As requested, the following excerpts are paragraphs in SFFAC 2 and SFFAS 1-8 that allude to the objectives of federal financial reporting. I tried not to include the word "objective" in other contexts, e.g., when it refers to a "cost object" or to the objective of a program. Some of those may have slipped in, however; conversely, I may have overlooked some references to objectives of financial reporting. Time did not permit doing this for all SFFAS and SFFAC, but this more limited selection may be more indicative of the ideas of the initial FASAB members who were responsible for SFFAC 1.

References to <u>OBJECTIVES</u> in SFFAS 1
(Published before SFFAC 1 was published.)

3 In a separate project, the Board is identifying users' needs and federal accounting and reporting **<u>OBJECTIVES</u>**. Although the Board's deliberation on **<u>OBJECTIVES</u>** has not been finalized, there is a general consensus that one overall **<u>OBJECTIVE</u>** for accounting and financial reporting is to assure accountability of federal government entities. The Board believes that issuing these selected standards will help in fostering that overall **<u>OBJECTIVE</u>**.

4. Specifically, the recommended standards would assist users of financial statements in:

- Assessing the efficiency and effectiveness of the government's management of its assets and liabilities, and
- Determining whether the government's financial position improved or deteriorated over the reporting period.

6 Although the Title 2 standards had not been fully implemented by federal agencies, they represented a starting point for further analysis. The Title 2 standards were reviewed in light of the accounting and reporting requirements established in the Chief Financial Officers (CFOs) Act of 1990. At the same time, the Board considered current accounting practices of federal agencies. It also considered the findings from its project on user needs and **<u>OBJECTIVES</u>** of federal financial reporting. As a result of the review, the Board decided that with certain modifications, accounting standards for selected assets and liabilities could be recommended to the JFMIP principals.

9 In preparing this Statement of recommended standards, the Board considered the respondents' comments. Based on the comments the Board received and its reevaluation in relation to the Board's current thinking on user needs and **<u>OBJECTIVES</u>** of federal

financial reporting, the Board made changes to the proposals contained in the Exposure Draft. The specific changes are discussed in Appendix A, "Basis of the Board's Conclusions."

90 The Board has decided to postpone consideration of the net financial resources concept. The Board believes that the usefulness of the concept can be further explored after it completes its project on users' needs and **OBJECTIVES** for financial accounting and reporting.

References to <u>OBJECTIVES</u> in SFFAS 2
(Published before SFFAC 1 was published)

11 The Federal Credit Reform Act of 1990 requires that effective October 1, 1991, the cost of direct loans and loan guarantees be estimated at present value for the budget. The **<u>OBJECTIVES</u>** of using the present value measurement in federal credit reform are to measure, recognize, and control subsidy costs of direct loans and loan guarantees. [Footnote 2] [Footnote 2: Congressional Budget Office, "Credit Reform: Comparable Budget Costs for Cash and Credit" (Dec. 1989), p.33.]

66 In proposing present value accounting, the Board's primary considerations were to carry out the intent of the Federal Credit Reform Act of 1990 and to make financial reporting compatible with the budget. (See Exposure Draft, Vol. 1, par. 15.) The Board believes that one of the **<u>OBJECTIVES</u>** of financial reporting is to enable the reader to determine the status of budgetary resources, and whether those resources were acquired and used in accordance with the enacted budget. [Footnote 11] [Footnote 11: FASAB Exposure Draft, **<u>OBJECTIVES</u>** of Federal Financial Reporting, Vol. 1, par. 13.]

References to OBJECTIVES in SFFAC 2

6 The concepts, as defined in this statement, are intended primarily for the general purpose financial reporting performed by Federal entities. This is the financial reporting that these entities would undertake to help meet the **OBJECTIVES** defined in Statement of Federal Financial Accounting Concepts (SFFAC) No. 1, "**OBJECTIVES** of Federal Financial Reporting." These **OBJECTIVES** are as follows:

- **Budgetary integrity.** Federal financial reporting should assist in fulfilling the government's duty to be publicly accountable for monies raised through taxes and other means and for their expenditure in accordance with the appropriations laws that establish the government's budget for a particular fiscal year and related laws and regulations.

- **Operating performance.** Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities.

- **Stewardship.** Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial conditions have changed and may change in the future.

- **Systems and control.** Federal financial reporting should assist report users in understanding whether financial management systems and internal accounting and administrative controls are adequate to ensure proper execution of transactions, safeguard assets, and support performance measurement.

43 There are instances when, for political or other reasons, an organization (including a government corporation), program, or account is not listed in the "Federal Programs by Agency and Account," yet the general purpose financial statements would be misleading or incomplete--in regard to the **OBJECTIVES** for Federal financial reporting--if the organization, program, or account were not included therein. These organizations, programs, or accounts would normally be considered to be operating at the "margin" of what would be considered a governmental function in contrast to providing a more basic governmental function. Thus, in addition to the conclusive criterion, there are several **indicative criteria** that should be considered in the aggregate for defining a financial reporting entity in the Federal Government. No single indicative criterion is a conclusive criterion in the manner that appearance in the "Federal Programs by Agency and Account" section of the budget is. Nor can weights be assigned to the indicative criteria. Thus, while the indicative criteria are presented in descending order of importance, judgment must be based on a consideration of all of the indicative criteria.

56 In the Federal Government, there are several types of reporting entities (organizations, suborganizations, programs, and the government as a whole) and several financial reporting **OBJECTIVES** (budgetary integrity, operating performance, stewardship, and systems and control). Each of the reporting **OBJECTIVES** can be met to a certain degree by the statements prepared by or for one type of reporting entity and to a greater or lesser degree by the statements prepared by or for the other types of reporting entities. For example, the **OBJECTIVE**

of budgetary integrity can be best met with the program and financing schedules prepared for individual budget accounts. The **OBJECTIVE** of operating performance can be best met with financial statements from organizations/suborganizations and programs (although financial statements at this level can also help readers evaluate the reporting entity's budgetary integrity). The **OBJECTIVE** of stewardship can be best met with a financial statement for the entire government. Meeting the financial reporting **OBJECTIVES** in their totality requires financial statements from all of the types of reporting entities.

57 The financial reporting **OBJECTIVES** are also met with different types of financial statements. A financial statement that presents financial information for an entity as of a particular point in time, however the information is measured, i.e., budgetary, cash, or accrual, is often characterized as a stock statement. An example of a stock statement is a **balance sheet**. It presents the total balances of assets, liabilities, and net position of an organization as of a specific time.

59 The Federal Government and most of the other reporting entities in the Federal Government are spending entities whose **OBJECTIVE** is to provide services, some of which are financed by revenues received from the recipients of the service, and some of which, if not all or most of which, are financed by taxes and other unearned revenues.[1] Thus, the most useful information a flow statement could present is the total and net costs of the services, i.e., how much of the services provided by the entity was financed by the taxpayers. This type of statement, which would be a **statement of net costs**, would support the achievement of Federal financial reporting **OBJECTIVE** 2A. **OBJECTIVE** 2A states that "Federal financial reporting should provide information that helps the reader to determine the costs of providing specific programs and activities and the composition of, and changes, in these costs."

60 As indicated, revenues provided in exchange for the services, i.e., earned revenues, are not the only manner in which a Federal Government entity finances the services it provides. Other sources of financing are the appropriations received from the Congress, and such various non-exchange revenues as fines, donations, and transfers from other agencies. Therefore, another useful flow statement would be a **statement of changes in net position** that presents the manner in which the entity's net costs were financed and the resulting effect on the entity's net position. This also would be consistent with Federal financial reporting **OBJECTIVE** 2: "Federal financial reporting should assist report users in evaluating. . .the manner in which these efforts and accomplishments have been financed...."

63 Meeting the first **OBJECTIVE** of SFFAC No. 1, "**OBJECTIVES** of Federal Financial Reporting," namely the budgetary integrity **OBJECTIVE**, necessitates that the reader receive assurance that

- the amounts obligated or spent did not exceed the available budget authority,
- obligations and outlays were for the purposes intended in the appropriations and authorizing legislation,

[1]The Board is currently developing an Exposure Draft entitled "Revenue and Other Financing Sources" which addresses more fully the types of revenues (i.e., exchange versus non-exchange and earned versus unearned revenues) discussed here.

- other legal requirements pertaining to the account have been met, and

- the amounts are properly classified and accurately reported.

65 The second **OBJECTIVE** of Federal financial reporting states, in part, that Federal financial reporting should provide information that helps readers of the financial reports determine the efforts and accomplishments associated with Federal programs and the changes over time and in relation to costs. This suggests that a **statement of program performance measures**,[2] i.e., one or more statements presenting service efforts and accomplishments measures for each of a reporting entity's significant programs, is necessary.

66 The Federal Government is increasing its interest in measuring and reporting program performance, as evidenced by the enactment of the Government Performance and Results Act and increasing emphasis during budget reviews on program performance. Moreover, the ability to seek and obtain maximum return from increasingly limited resources can be enhanced by an understanding of the results of the programs for which budget resources have been expended. In the final analysis, the **OBJECTIVE** of the Federal Government is to provide services, in contrast to the **OBJECTIVE** of private sector organizations, which is to earn profits and enhance the return on investment, both of which are monetary **OBJECTIVES**. All of these factors suggest that the statement of program performance measures is not only an appropriate statement, but likely to be the most important statement for those persons interested in how a Federal entity is using its resources.

70 The third **OBJECTIVE** of Federal financial reporting is that it "should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial conditions have changed and may change in the future."[3] This **OBJECTIVE** requires a reporting of information concerning investments in education, training, research, and development and certain types of property, plant, and equipment that can affect the nation's future wealth, and to the claims on future budgetary resources resulting from prior decisions and actions.

71 The information pertaining to the aforementioned investments, certain types of property, plant, and equipment,[4] and claims on future budgetary resources is maintained in part in the entities' general ledgers and, in part, external to the general ledgers. Some of the information is recorded in units other than dollars, e.g., acres, millions of square feet. Finally, some of the information is not subject to the types of controls present in a system of double entry record keeping. Accordingly, a more suitable way to fulfill the third reporting **OBJECTIVE** would be to display

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[2]The Board does not consider the Statement of Program Performance Measures to be a basic financial statement.

[3]A complete discussion of the third **OBJECTIVE** for Federal financial reporting, which is called the "stewardship **OBJECTIVE**," is contained on pages 41-45 in Statement of Federal Financial Accounting Concepts No. 1, "**OBJECTIVES** of Federal Financial Reporting."

[4]The Board is currently considering accounting standards for Federally-owned property, plant, and equipment. These standards will address placement of information related to various types of PP&E. The Board is considering placing information about some types of PP&E in footnotes with information about other types in required supplemental information. The Board's proposals will be presented in an exposure draft on stewardship reporting.

the appropriate information as **required supplemental information** rather than attempting to include it in financial statements.[5]

73 The fourth **OBJECTIVE**, systems and controls, is fulfilled, in part, by the act of preparing the financial statements. Other ways the fourth **OBJECTIVE** could be fulfilled through the audited financial reporting process is by a management assertion that would accompany the financial statements and/or an auditor's attestation on the financial statements. The management assertion would be an acknowledgment of its responsibility for the accuracy of the information in the financial statements, the completeness and fairness of the presentation of the information, the accuracy of the information in all material respects, and the reporting of the information in a manner designed to fairly present financial position and results of operations. The assertion could also include a statement regarding the adequacy of the entity's systems and controls, accompanied by the auditor's concurrence with the assertion.

74 Meeting the four **OBJECTIVES** of Federal financial reporting in the most efficient manner suggests that reporting entities issue a financial report that would include the following:

- management discussion and analysis;
- balance sheet;
- statement of net costs;
- statement of changes in net position;
- statement of custodial activities, when appropriate;
- statement of budgetary resources;
- statement of program performance measures;[6]
- accompanying footnotes;
- required supplemental information pertaining to physical, human, and research and development capital and selected claims on future resources, when appropriate; and
- other supplemental financial and management information, when appropriate.

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[5]Required supplemental information is information that would be reported outside the principal financial statements that the Federal Accounting Standards Advisory Board considers an essential part of a reporting entity's financial reporting, and therefore recommends authoritative guidelines for the measurement and presentation of the information. It is analogous to the required supplementary information discussed in Statement on Auditing Standards-AU Section 558.06, which addresses pronouncements of the Financial Accounting Standards Board and the Governmental Accounting Standards Board.

[6]The statement of program performance measures is not a basic financial statement. Nevertheless, it is an important component of the financial reports.

References to <u>OBJECTIVES</u> in SFFAS 3

From Appendix A, Basis for Conclusions:

Some respondents believed that the Board should adopt the lower of cost or market (LCM) rule (traditional under Accounting Research Bulletin (ARB) 43) for valuing inventory. Respondents supporting the LCM rule stated that:

-- it provides a basis for measuring the utility of inventory, and

-- the operating performance financial reporting **<u>OBJECTIVE</u>** seems to require that matching or assigning revenues and expenses to the appropriate period be a primary concern.

In evaluating the LCM rule the Board considered some of the unique facets of the Federal environment:

-- pricing is often based on full cost recovery regardless of changes in market pricing, and

-- managers are often required to stock inventory based on legislative or mission concerns that are not driven by profit maximization (therefore, cost fluctuations are not as relevant to performance measurement).

The Board concluded that there was no need to include the LCM rule in the inventory standards.

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An extensive discussion of the Board's overall decision to require present value accounting is presented in Recommended Accounting Standard No. 2, <u>Accounting for Direct Loans and Loan Guarantees</u> (see Appendix A). One of the **<u>OBJECTIVES</u>** of financial reporting is to enable the reader to determine the status of budgetary resources, and whether those resources were acquired and used in accordance with the enacted budget.[7] The Board believes that only by using the same basis can financial information be used to compare the actual results of operations with the budget.

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[7] [footnote 15 in original] FASAB Exposure Draft, **<u>OBJECTIVES</u>** of Federal Financial Reporting, Vol. 1, par. 13.

References to **<u>OBJECTIVES</u>** is SFFAS 4

13. Reliable information on the costs of federal programs and activities is crucial for effective management of government operations. In Statement of Federal Financial Accounting Concepts (SFFAC) No. 1, **OBJECTIVES** of Federal Financial Reporting, issued in 1993, it is stated that the **OBJECTIVES** of federal financial reporting are to provide useful information to assist internal and external users in assessing the budget integrity, operating performance, stewardship, and systems and control of the federal government.[8]

14. Managerial cost accounting is especially important for fulfilling the **OBJECTIVE** of assessing operating performance. In relation to that **OBJECTIVE**, it is stated in SFFAC No. 1 that federal financial reporting should provide information that helps users to determine:

- Costs of specific programs and activities and the composition of, and changes in, those costs;

- Efforts and accomplishments associated with federal programs and their changes over time and in relation to costs; and

- Efficiency and effectiveness of the government's management of its assets and liabilities.[9]

15. It is further stated in SFFAC No. 1 that "The topics of costs and performance measurement are related because it is by associating cost with activities or cost **OBJECTIVES** that accounting can make much of its contribution to reporting on performance."[10] "Cost" is the monetary value of resources used or sacrificed or liabilities incurred to achieve an **OBJECTIVE**, such as to acquire or produce a good or to perform an activity or service. Costs incurred may benefit current and future periods. In financial accounting and reporting, the costs that apply to an entity's operations for the current accounting period are recognized as expenses of that period.

19. *Government managers* are the primary users of cost information. They are responsible for carrying out program **OBJECTIVES** with resources entrusted to them. Reliable and timely cost information helps them ensure that resources are spent to achieve expected results and outputs, and alerts them to waste and inefficiency.

22. The managerial cost accounting concepts and standards presented here are intended for all the user groups identified above. These standards are aimed at achieving three general **OBJECTIVES**:

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[8] Statement of Federal Financial Accounting Concepts No. 1, **OBJECTIVES** of Federal Financial Reporting (September 2, 1993), pars. 110 and 111, pages 34-35.

[9] Ibid., pars. 126-130, pages 39-40.

[10] Ibid., par. 192, page 63.

- Provide program managers[11] with relevant and reliable information relating costs to outputs and activities. Based on this information, program managers can respond to inquiries about the costs of the activities they manage. The cost information will assist them in improving operational economy and efficiency;

- Provide relevant and reliable cost information to assist the Congress and executives in making decisions about allocating federal resources, authorizing and modifying programs, and evaluating program performance; and

- Ensure consistency between costs reported in general purpose financial reports and costs reported to program managers. This includes standardizing terminology for managerial cost accounting to improve communication among federal organizations and users of cost information.

42. Managerial cost accounting is the process of accumulating, measuring, analyzing, interpreting, and reporting cost information useful to both internal and external groups concerned with the way in which the organization uses, accounts for, safeguards, and controls its resources to meet its **OBJECTIVES**. Managerial cost accounting, therefore, is the servant of both budgetary and financial accounting and reporting because it assists those systems in providing information. Also, it provides useful information directly to management. These relationships are shown in Figure 1.

45. Managerial cost accounting, financial accounting, and budgetary accounting draw information as needed from the common data source. The data obtained by each of these is processed to attain specific **OBJECTIVES** by reporting useful information.

48. Traditionally, managerial cost accounting information pertaining to financial accounting has involved costs of past transactions and the assignment of transaction value to fiscal periods and outputs. These purposes and uses are closely aligned with the financial accounting activity and traditional external financial reporting. This past cost aspect has been acknowledged in **OBJECTIVES** of Federal Financial Reporting which states that "financial accounting is largely concerned with assigning the value of past transactions to appropriate time periods."[12]

54. While managerial cost accounting is concerned not only with past costs and future costs, one of its most important features is the use of present costs to assist management. This current cost aspect of managerial cost accounting is referred to in the **OBJECTIVES** of Federal Financial Reporting where is states that "accounting data may be further assigned, allocated, or associated with units of activity or production, segments of organizations, etc., *within the same time period.* These kinds of *intraperiod*

[11] Statement of Federal Financial Accounting Concepts No.1, **OBJECTIVES** of Financial Reporting, defined "Program managers" as individuals who manage federal programs, and stated that "Their concerns include operating plans, program operations, and budget execution." SFFAC No. 1, par. 85, page 29.

[12] Statement of Federal Financial Accounting Concepts No.1, **OBJECTIVES** of Federal Financial Reporting, par. 168, page 55.

allocations are developed most extensively in the branch of accounting called cost accounting. Neither the FASB nor the GASB has devoted much attention to this branch of accounting, but the FASAB, because of its unique mission, will need to do so."[13] Managerial cost accounting information pertaining to present costs is most often used for controlling and reducing those costs, controlling work processes, and measuring current performance.

55. Proper financial management requires that the three accounting processes work closely together to provide useful reporting to both internal and external users. The internal-external dual focus of federal reporting has been established in the **OBJECTIVES** of Federal Financial Reporting. It states that "The FASAB and its sponsors believe that any description of federal financial reporting **OBJECTIVES** should consider the needs of both internal and external users and the decisions they make." In addition, it says that "the FASAB...considers the information needs of both internal and external users. In part, this is because the distinction between internal and external users is in many ways less significant for the federal government than for other entities." It goes on to classify the users of financial information into four major groups: program managers, executives, the Congress, and citizens.[14] These categories include both internal and external users.

58. One of the most important aspects of reporting in which managerial cost accounting plays a large role is that of performance reporting. Measuring and reporting actual performance against established goals is essential to assess governmental accountability. Cost information is necessary in establishing strategic goals, measuring service efforts and accomplishments, and relating efforts to accomplishments. The importance of cost information in relation to performance measurement and performance reporting has been recognized in the **OBJECTIVES** of Federal Financial Reporting, which said "One reason for performing cost accounting is to assist in performance measurement" and it also stated that "The topics of cost and performance measurement are related because it is by associating cost with activities or 'cost **OBJECTIVES**' that accounting can make much of its contribution to reporting on performance."[15]

59. Costs may be measured, analyzed, and reported in many ways. A particular cost measurement has meaning only when considering its purpose. The measurement of costs can vary depending upon the circumstances and purpose for which the measurement is to be used. In **OBJECTIVES** of Federal Financial Reporting, it is stated that "the Board's own focus is on developing generally accepted accounting standards for reporting on the financial operations, financial position, and financial condition of the federal government and its component entities and other useful financial information. This implies a variety of measures of costs and other information that complements the information available in the budget [emphasis added]."[16]

71. Regardless of whether a reporting entity uses a cost accounting system or cost finding techniques, the methods and procedures followed should be designed to perform at least a certain minimum level of cost accounting and provide a basic amount of cost information necessary to accomplish the many **OBJECTIVES** associated with planning, decision making, control, and reporting. The more important

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[13] Statement of Federal Financial Accounting Concepts No. 1, **OBJECTIVES** of Federal Financial Reporting, par. 174, page 56.
[14] Ibid., pars. 23, 25, page 9; and par. 75, page 26.
[15] Ibid., par. 174, page 56; and par. 192, page 63.

of these minimum criteria for cost accounting are associated with the standards in the remainder of this statement. Others are also important. . . .

181. FASAB is different in that it has determined that some of the users of federal government financial reports are internal to the government. Given the nature and size of the federal government, internal users often do not have the same type of access to cost information that may be available in commercial enterprises. In addition, the Board views cost accounting information as vital to both internal and external users. The Board has previously determined in its **OBJECTIVES** of Financial Reporting that cost information should be reported to meet the needs of Congress, federal executives, and others.

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[16] Ibid., par. 191, page 62.

References to <u>OBJECTIVES</u> in SFFAS 5

8 When developing accounting standards for the federal government, the significant environmental differences between the federal government and the private sector must be kept in mind. Statement of Federal Financial Accounting Concepts Number 1, ***OBJECTIVES*** *of Federal Financial Reporting*, discusses the federal accounting and financial reporting environment. It notes the following:

> The federal government is unique, when compared with any other entity in the country, because it is the vehicle through which the citizens of the United States exercise their sovereign power. The federal government has the power through law, regulation, and taxation to exercise ultimate control over many facets of the national economy and society. All other entities within the nation, both public and private, operate within the context of laws, oversight, and accountability established by the national government. The federal government is accountable only to its citizens. It is politically accountable to the electorate, but no higher agency has the power to demand an accounting from the government.

9 The **OBJECTIVES** of federal financial reporting were designed to guide the Board in developing accounting standards to enhance the financial information reported by the federal government. The four **OBJECTIVES** are discussed under the headings (1) budgetary integrity, (2) operating performance, (3) stewardship, and (4) systems and control. These **OBJECTIVES** were used as a basis to develop the Liability Statement. The Board believes that the operating performance **OBJECTIVE** has special relevance to decisions about recognition and measurement of liabilities in general purpose federal financial reports. That **OBJECTIVE** reads as follows:

> Federal financial reporting should assist report users in evaluating the service efforts, cost, and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities.[17]

10 At the same time, the Board recognizes that the third **OBJECTIVE**, dealing with stewardship, is equally important.

> Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial conditions have changed and may change in the future.

Federal financial reporting should provide information that helps the reader to determine:

- whether the government's financial position improved or deteriorated over the period;
- whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due; and
- whether government operations have contributed to the nation's current and future well-being.

Examples of information relevant to this **OBJECTIVE** include:

- the amount of assets, liabilities, and net assets (or net position);

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t of Federal Financial Accounting Concepts Number 1, ***OBJECTIVES*** *of Federal Financial Reporting* (Sept. 2, 1993).

- an analysis of government debt, its growth, and debt service requirements;
- changes in the amount and service potential of capital assets; and
- the amount of contingent liabilities and unrecognized obligations[18] (such as the probable cost of deposit insurance).

Accordingly, information about projected future responsibilities and resources is as important as information about assets, liabilities, revenues, and expenses.

8 When developing accounting standards for the federal government, the significant environmental differences between the federal government and the private sector must be kept in mind. Statement of Federal Financial Accounting Concepts Number 1, ***OBJECTIVES** of Federal Financial Reporting*, discusses the federal accounting and financial reporting environment. It notes the following:

> The federal government is unique, when compared with any other entity in the country, because it is the vehicle through which the citizens of the United States exercise their sovereign power. The federal government has the power through law, regulation, and taxation to exercise ultimate control over many facets of the national economy and society. All other entities within the nation, both public and private, operate within the context of laws, oversight, and accountability established by the national government. The federal government is accountable only to its citizens. It is politically accountable to the electorate, but no higher agency has the power to demand an accounting from the government.

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Federal financial reporting should provide information that helps the reader to determine:

"obligation" is used in its everyday or generic sense, not as it is used in federal budgetary accounting.

t of Federal Financial Accounting Concepts Number 1, ***OBJECTIVES*** *of Federal Financial Reporting* (Sept. 2, 1993).

- whether the government's financial position improved or deteriorated over the period;
- whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due; and
- whether government operations have contributed to the nation's current and future well-being.

Examples of information relevant to this **OBJECTIVE** include:

- the amount of assets, liabilities, and net assets (or net position);
- an analysis of government debt, its growth, and debt service requirements;
- changes in the amount and service potential of capital assets; and
- the amount of contingent liabilities and unrecognized obligations[20] (such as the probable cost of deposit insurance).

Accordingly, information about projected future responsibilities and resources is as important as information about assets, liabilities, revenues, and expenses.

126 As noted in SFFAC No. 1, ***OBJECTIVES*** *of Federal Financial Reporting*: "The accounting process begins with recording information about transactions between the government (or one of its component entities) and other entities, that is, inflows and outflows of resources or promises to provide them."[21] In some transactions, consideration of value is exchanged: there is a reciprocal or two-way flow. Other transactions, such as grants and other transfer payments are nonexchange transactions (i.e., there is a nonreciprocal transaction--normally a one-way flow).

148 A primary **OBJECTIVE** for federal financial reporting is to measure accurately the full cost of employer entity services to the public. The methods used to account for pensions, ORB, and OPEB in general purpose financial reports should accurately measure the full cost of an employer entity's services. Since federal pension benefits are based on final salaries, whatever method is used for the annual cost and accrued liability of federal pensions must include projected future salaries that reflect an estimate of the compensation levels of the individual employees involved (including future changes attributable to the general price level, seniority, promotion, and other factors). They are part of the obligation that the federal government is incurring.

"obligation" is used in its everyday or generic sense, not as it is used in federal budgetary accounting.
ragraph (16c).

References to <u>OBJECTIVES</u> in SFFAS 6

1 The purpose of this statement is to provide accounting standards for Federally owned property, plant, and equipment (PP&E); deferred maintenance; and cleanup costs. This introduction provides information on:

- •. the scope of the standards,
- •. consideration of reporting **<u>OBJECTIVES</u>**,
- •. applicability of the standards,
- •. capitalization threshold,
- •. materiality, and
- •. effective date.

9 In drafting accounting standards for PP&E, the Board relied on its Statement of Federal Financial Accounting Concepts Number 1, ***<u>OBJECTIVES</u>*** *of Federal Financial Reporting*. Ultimately, all accounting standards taken as a whole will help meet the four reporting **<u>OBJECTIVES</u>** expressed in the ***<u>OBJECTIVES</u>*** statement: budgetary integrity, operating performance, stewardship, and systems and control. The focus of these standards is on the two reporting **<u>OBJECTIVES</u>** most relevant to PP&E--operating performance and stewardship. These **<u>OBJECTIVES</u>** and how they could be met through PP&E accounting are discussed under the headings (1) operating performance, and (2) stewardship.

OPERATING PERFORMANCE

10 The Board believes that it can contribute to meeting the operating performance **OBJECTIVE**[22] by measuring the cost associated with using property, plant, and equipment and including that cost in entity operating results. The Board first sought to identify PP&E costs that would be appropriate to include in operating expense. Then, from consideration of cost information required, the Board determined what balance sheet information would have to be reported.

11 To meet the operating performance **OBJECTIVE**, the Board seeks to provide accounting standards that will result in:

- relevant and reliable cost information for decision-making by internal users (e.g., program managers, budget examiners and officials),
- comprehensive, comparable cost information for decision-making and program evaluation by Congress and the public, and
- information to help assess the efficiency and effectiveness of asset management (e.g., condition of assets including deferred maintenance).

RDSHIP

12 The Board believes that Federal financial reporting can fulfill the stewardship **OBJECTIVE**[23] if the Board provides standards that will result in reporting information on:

- asset condition;
- changes in the amount and service potential of property, plant, and equipment;
- cost of property, plant, and equipment where applicable; and
- spending for acquisition of property, plant, and equipment versus non-capital spending.

118 The Board found that a single accounting method for such diverse Federal PP&E would not meet the **OBJECTIVES** established in its ***OBJECTIVES*** *of Federal Financial*

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[22]Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities. Federal financial reporting should provide information that helps the reader to determine:
a. the costs of providing specific programs and activities and the composition of, and changes in, these costs.
b. the efforts and accomplishments associated with Federal programs and the changes over time and in relation to costs.
c. the efficiency and effectiveness of the government's management of its assets and liabilities.

[23]Federal financial reporting should assist users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial conditions have changed and may change in the future. Federal financial reporting should provide information that helps the reader to determine:
a. whether the government's financial position improved or deteriorated over the period.
b. whether the future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.
c. whether government operations have contributed to the nation's current and future well-being.

Reporting. Therefore, the Board identified categories of PP&E and set different accounting methods for each category.

122 Allocation of the cost of general PP&E, excluding land, among accounting periods is essential to assessing operating performance. The Board's concepts statement, ***OBJECTIVES*** *of Federal Financial Reporting*, focuses on relating cost to accomplishments in reporting an entity's operating performance. Cost information is of fundamental importance both to program managers in operating their activities efficiently and effectively and to executive and congressional decision makers in deciding on resource allocation. General PP&E will be capitalized and depreciated to provide this information.

ship PP&E

123 For stewardship PP&E,[24] the predominant reporting **OBJECTIVE** is stewardship. This is in contrast to general PP&E, for which the Board is concerned with providing information to assess operating performance and, therefore, provided for depreciation accounting. The most relevant information is about the existence of stewardship PP&E and that information can be provided through a new type of reporting--supplementary stewardship reporting.

124 For stewardship PP&E, the Board believes that allocation of historical cost to operating expense for each period would not contribute to the measurement of entity operating performance. Prior to issuing its ***OBJECTIVES*** statement, the Board conducted a user needs study and met with representatives of a wide variety of user groups. Most users specifically indicated that depreciating stewardship PP&E such as weapons systems would not provide meaningful information for assessing the entity's operating performance. The Board believes that its standards should address the needs of users and the Board has found that users do not need information which includes depreciation expense on this category of PP&E.

125 The Board noted in its ***OBJECTIVES*** statement that the government's responsibility for the nation's common defense and general welfare is unique and that, in some cases, the most relevant measures of performance are nonfinancial.[25] Despite the preference for nonfinancial performance measures for stewardship PP&E, the government must demonstrate that it is being an appropriate "steward" for these assets. To meet the stewardship **OBJECTIVE**, the government must be able to answer basic questions such as:

- What and where are the important assets?
- Is the government effectively managing and safeguarding its assets?

155 A few respondents supported the alternative view that would limit depreciation accounting to business-type activities. They argued that depreciation was only necessary where expenses were to be matched to revenues. This view is contrary to the operating performance **OBJECTIVE** and would not support development of cost information to associate with performance measures.

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[24]The term "stewardship PP&E" is used to refer collectively to federal mission PP&E, heritage assets, and stewardship land.

196 The Board believes that the standards it has developed will contribute to meeting the operating performance and stewardship reporting **OBJECTIVES** of Federal financial reporting. The cleanup cost standards have not been modified for either of these recommendations.

Cost object (also referred to as cost OBJECTIVE) - An activity, output, or item whose cost is to be measured. In a broad sense, a cost object can be an organizational division, a function, task, product, service, or a customer.

Direct Cost - The cost of resources directly consumed by an activity. Direct costs are assigned to activities by direct tracing of units of resources consumed by individual activities. A cost that is specifically identified with a single cost **OBJECTIVE**.

[25] **OBJECTIVES**, paragraph 54.

References in SFFAS 7

1. This Statement presents standards to account for inflows of resources from revenue and other financing sources. It provides standards for classifying, recognizing, and measuring resource inflows. These financial (proprietary) accounting standards differ from those used for budgetary accounting only to the extent essential to meet the **OBJECTIVES** of Federal Financial Reporting.

15. This statement amends Statement of Federal Financial Accounting Concepts No. 2, Entity and Display, by adding a category of financial information to further satisfy users' needs and the **OBJECTIVES** of financial reporting. More specifically, the amendment is designed to meet users' need to understand "how information on the use of budgetary resources relates to information on the cost of program operations . . ." (sub-**OBJECTIVE** 1C). The **OBJECTIVE** of this new category of information is to provide an explanation of the differences between budgetary and financial (proprietary) accounting. This is accomplished by means of a reconciliation of budgetary obligations and nonbudgetary resources available to the reporting entity with its net cost of operations.

16. The essential differences among exchange revenues, nonexchange revenues, and other financing sources affect the way they are recognized and measured under the accrual method of accounting. Properly classifying these inflows according to their nature, therefore, provides the basis for applying different accrual accounting principles. In addition, proper classification is essential to constructing financial statements that meet the federal financial reporting **OBJECTIVES**, as they have been described in Statement of Federal Financial Accounting Concepts No. 2, Entity and Display.

17. To help meet those **OBJECTIVES**, classifications were developed to determine what specific kinds of revenue should be deducted from the cost of providing goods and services by the reporting entities. Only revenue classified as exchange revenue should be matched with costs. Nonexchange revenue and other financing sources are not matched with costs because they are not earned in the operations process. Because they are inflows that finance operations, nonexchange revenues and other financing sources should be classified in accordance with other rules and should be recognized only in determining the overall financial results of operations for the period. This differs from the focus used in the private sector, where the focus is on net income for business organizations, and on changes in net assets for not-for-profit organizations. It is also a different focus from that used previously in reporting on U.S. Government operations. Under the old federal accounting standards, the focus was on matching all of an entity's financing with incurred expenses to report "net results of operations" which generally was not useful in evaluating performance. The new focus is on costs --both gross and net--which are useful in evaluating performance on many levels.

69.1. **A perspective on the income tax burden.** The IRS should provide a perspective on the income tax burden. This could take the form of a summary of the latest available information on the income tax and on related income, deductions, exemptions, and credits for individuals by income level and for corporations by size of assets. The **OBJECTIVE** is to show the tax burden borne by different classes of individuals and corporations and how that burden is affected by the tax rates, deductions, credits, etc., provided by the tax laws.

88. The Statement of Federal Financial Accounting Concepts (SFFAC) No. 2, Entity and Display, was issued to provide conceptual guidance as to what would be encompassed by a federal entity's financial report. It identifies the types of financial information to be communicated to users and suggests the types of information to be included in an entity's report to help meet the **OBJECTIVES** of federal financial reporting. Among other things, SFFAC No. 2 supports reporting both budget information and operating performance (i.e., proprietary) information to meet the needs of users and the **OBJECTIVES** of reporting. The budget information focuses on the obligation and outlay of financial resources to acquire or provide goods and services as defined by budget concepts. Operating performance information focuses on the cost of resources used as defined by accrual accounting standards.

91. Sub**OBJECTIVE** 1C of the budgetary integrity **OBJECTIVE** states that information is needed to help the reader to determine "how information on the use of budgetary resources relates to information on the costs of program operations and whether information on the status of budgetary resources is consistent with other accounting information on assets and liabilities." This **OBJECTIVE** arises because accrual-based expense measures used in financial statements differ from the obligation-based measures used in the budgetary reports.

92. To satisfy this **OBJECTIVE**, information is needed about the differences between budgetary and financial (i.e., proprietary) accounting that arise as a result of the different measures. This could be accomplished through a **Statement of Financing** that reconciles the budgetary resources obligated for a federal entity's programs and operations to the net cost of operating that entity. The data presented could be for the reporting entity as a whole, for the major suborganization units, for major budget accounts, or for aggregations of budget accounts, rather than for each individual budget account of the entity.

114. The **OBJECTIVES** of Federal Financial Reporting focuses on cost in relationship to accomplishment as the main **OBJECTIVE** in reporting an entity's operating performance. This is because of the fundamental importance of cost information. It is important to program managers in operating their activities efficiently and effectively. It is equally important to Executive and Congressional decision makers in making resource allocations. Sub**OBJECTIVES** 2A and 2B declare that:

> Federal financial reporting should provide information that helps the reader to determine ...the costs of providing specific programs and activities and the components of, and changes in, these costs...[and] the efforts and accomplishments associated with federal programs and the changes over time and in relation to costs.[i]

115. The Board's explanation of the operating performance **OBJECTIVE** defines more exactly what this means:

> ...expenses can be matched against the provision of services year by year. The resulting cost can then be analyzed in relationship to a variety of measures of the achievement of results.[26]

116. SFFAS 4, Managerial Cost Accounting Concepts and Standards, discusses the need for Government accounting to emphasize cost as a way to improve decision making and program management. It says that good cost information can be used for: (1) budgeting and cost control, (2) performance measurement, (3) determining reimbursements and setting fees, (4) program evaluations, and (5) economic choice decisions (such as whether to contract-out a project).[27]

117. To meet these goals, cost must be matched with the provision of goods and services to the public or other Government entities. To determine the net cost of an exchange activity--i.e., the part of the cost that is not offset by revenue earned from the goods and services provided--the related revenue must be matched with the cost.

118. Matching revenue with cost in a uniform manner is essential in evaluating agency performance and setting price. Cost and revenue must pertain to the same output in order to estimate the extent to which the revenue covers the cost. Therefore, costs should be matched against the provision of goods and services with revenue matched against those costs and thus with revenue also matched against the same provision of goods and services. When this is done, the gross and net cost of an entity can be compared with the related outputs and outcomes to evaluate its operating performance, pricing policy, and economic decisions. Similarly, when this is done, the net cost to the taxpayer can be estimated for the entity's related outputs provided to the public.

38, para. 124. For more extended discussion, see ibid., chapter 8. As explained there, difficulties arise in practice for many reasons, fic measures that are appropriate and feasible will vary from program to program, outcomes are influenced by external factors as well government, focusing attention on selected measures can have unintended--and sometimes undesired--consequences, etc.
. 4, Managerial Cost Accounting Concepts and Standards for the Federal Government, pp. 11-14.

135. Determining the subsidy cost in this way is a method of matching revenue with cost, and it is also a method of matching the subsidy cost with the provision of the subsidy to the public. SFFAS No. 2 is therefore consistent with the **OBJECTIVES** of this Statement for exchange revenue, and the standards in this Statement do not apply to the recognition and measurement of revenue and credit losses for direct loans and loan guarantees that follow credit reform accounting. This exception includes pre-1992 direct loans and loan guarantees that have been restated on a present value basis. The guidance for classifying transactions in Appendix B reflects the provisions of SFFAS No. 2.

192. Tax expenditures are estimates of the revenue forgone because of preferential provisions of the tax structure. They are due to special exclusions, exemptions, deductions, credits, deferrals, and tax rates that depart from a "baseline." These exceptions are generally intended to achieve public policy **OBJECTIVES** by providing benefits to qualifying individuals or entities or by encouraging particular activities. They also may be intended to improve tax equity or offset imperfections in other parts of the tax structure. Tax expenditures are not revenue. They are not inflows of resources to the reporting entity.

201. Advocates of this requirement believe that financial reports that omit important financial effects of Governmental action do not fairly present the results of the Government's operations. Such reports fail to achieve the **OBJECTIVES** of federal financial reporting. They believe that the efforts and accomplishments with which an agency pursues its goals can be properly assessed only if the financial reports include all material information. This means that the reports should bring together information about the net cost of operations, the tax expenditures, and the directed flows of resources that are intended to achieve the same or similar missions.

203. The standards for other financing sources and budgetary resources should satisfy several of the **OBJECTIVES** of financial reporting such as: (1) explaining the relationship of budgetary resources obligated to the net cost of operations, (2) showing how budgetary resources were used and the status of budgetary resources at the end of the period, and (3) indicating the effect on the net results of operations of the entity of all the financing sources used to finance the net cost of operations. However, financing from a financial accounting (proprietary) perspective is different than the budgetary accounting perspective.

204. The budget is the primary financial planning and control tool of the Government. Its **OBJECTIVES**, such as planning resource allocation, authorizing and controlling obligations, planning cash disbursements, and raising revenue, differ from those of financial reporting where the focus is on net cost of the entity's programs and activities and stewardship of its assets and liabilities. Differing **OBJECTIVES** are responsible for some but not all of the many differences in these two financial management tools. Differences in standards for measuring and reporting budgetary and financial information, coupled with unreliable data, have caused financial

statements to be under-utilized by Government managers, the budget community, and others who might benefit from financial information.

207. However, differences inherent in the different **OBJECTIVES** of the budget and the financial statements must remain. The obligation basis for the budget differs from the costs-incurred basis for the financial statements. This difference must continue in order for both types of information to serve their purposes. Some budgetary resources are used to invest in assets and therefore are not reflected in operating costs. Also, an entity may incur costs that were covered by previously provided budgetary resources (e.g., depreciation), costs not yet covered by budgetary resources (e.g., accrued annual leave), or costs covered by budgetary resources of other entities (e.g., some pension costs). Continuing these differences in the accounting reports is essential if financial statements are to report cost information that can be related to entities' outputs and if the statements are to report other information on the resources over which the entities are accountable. These remaining differences need to be explained in the financial statements to increase the utility of the financial statements.

Budgetary Accounting

Budgetary accounting is the system that measures and controls the use of resources according to the purposes for which budget authority was enacted; and that records receipts and other collections by source. It tracks the use of each appropriation for specified purposes in separate budget accounts through the various stages of budget execution from appropriation to apportionment and allotment to obligation and eventual outlay. This system is used by the Congress and the Executive Branch to set priorities, to allocate resources among alternative uses, to finance these resources, and to assess the economic implications of federal financial activity at an aggregate level. Budgetary accounting is used to comply with the Constitutional requirement that “No Money shall be drawn from the Treasury, but in Consequence of Appropriations Made by Law; and a regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time.” (See Statement of Federal Financial Accounting Concepts No. 1, **OBJECTIVES** of Federal Financial Reporting, September 1993:15, 35-36, and 61-62.)

Cost

Defined in SFFAC No. 1, **OBJECTIVES** of Federal Financial Reporting as the monetary value of resources used (para. 195). Defined more specifically in SFFAS No. 4, Managerial Cost Accounting Concepts and Standards for the Federal Government, as the monetary value of resources used or sacrificed or liabilities incurred to achieve an **OBJECTIVE**, such as to acquire or produce a good or to perform an activity or service (page 105). Depending on the nature of the transaction, cost may be charged to operations immediately, i.e., recognized as an expense of the period, or to an asset account for recognition as an expense of subsequent periods. In most contexts within Accounting for Revenue and Other Financing Sources, "cost" is used synonymously with expense. See also "Full Cost."

References in SFFAS 8

a The purpose of this Statement is to establish standards for reporting on the Federal Government's stewardship over 1) certain resources entrusted to it, identified as stewardship property, plant, and equipment and stewardship investments, and 2) certain responsibilities assumed by it, identified as the current service assessment. The resources and responsibilities do not meet the criteria for assets and liabilities that are required to be reported in the financial statements but are, nonetheless, important to an understanding of the operations and financial condition of the Federal Government at the date of the financial statements and in subsequent periods. Because the Government has been entrusted with, and made accountable for, these resources and responsibilities, they should be recognized in the financial reports of the Federal Government and of its component entities. This determination was made to more fully satisfy the stewardship **OBJECTIVE** defined in the concepts statement, ***OBJECTIVES*** *of Federal Financial Reporting*.[28]

b The stewardship **OBJECTIVE** requires that the Federal Government "report on the broad outcomes of its actions." Such reporting will provide information that could help report users assess the impact of the Government's operations and activities for the period on its financial condition.[29]

c Stewardship resources involve substantial investment by the Federal Government for the benefit of the Nation. When made, they are treated as expenses in the financial statements. These expenses, however, are intended to provide long-term benefits to the public. Therefore, this Statement requires that information on these resources be reported to highlight their long-term-benefit nature and to demonstrate accountability over them. Depending on the nature of the resources, stewardship reporting could consist of financial and nonfinancial data.

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[28] ***OBJECTIVES*** *of Federal Financial Reporting*, SFFAC No. 1, September 1993.
[29] Ibid., pp. 41-42.

d This Statement also establishes a standard for reporting projections that will aid in assessing the sufficiency of future **budgetary resources** to sustain public services and meet obligations as they come due.

5 The Concepts Statement, ***OBJECTIVES*** *of Federal Financial Reporting* was developed on the basis of an in-depth assessment of user needs and is used to guide the Board in developing Federal accounting and reporting standards. The **OBJECTIVES** cover four areas: budgetary integrity, operating performance, stewardship, and systems and control.

6 This Statement of accounting standards addresses the **OBJECTIVE** of reporting on stewardship over certain resources entrusted to the Federal Government and responsibilities assumed by it. The need for a report on the Federal Government's stewardship over the resources entrusted to it and the responsibilities it has assumed, arises because of the unique nature of the Federal Government, as described in the following section.

Stewardship and the Reporting OBJECTIVES

7 "Financial position" is a representation of an entity's economic resources and the claims on those resources as of a particular date. In the private sector, the principal **OBJECTIVE** of reporting on financial position is to assess the viability of the entity, the business firm, and its potential profitability.

8 Assessing the overall performance of the Federal Government is not exclusively a matter of comparing revenue and expense, or its accumulated assets and liabilities.

9 The Federal Government's viability and perpetuity are assumed. It has unique access to financial resources and financing, and the power to tax, to borrow, and to create money. For the Federal Government, financial performance is a vital issue, but traditional financial measures provide data that are appropriate for assessing only some, not all, of the responsibilities for which the Government should be held accountable. Since it exists not to make a profit but to serve the needs of the citizens and to promote the general welfare of the Nation, other measures of accountability need to be used. Measures of accountability are to be reported for elements that are defined as **stewardship property, plant, and equipment (PP&E)**; **stewardship investments**; and **stewardship responsibilities**. These elements of stewardship exist because the Federal Government is dissimilar to industrial and commercial entities.

13 Because the Government has been entrusted with and made accountable for these resources, they should be reported in the financial reports of the Government and of its component entities. This will help satisfy the stewardship **OBJECTIVE** defined in the concepts statement, ***OBJECTIVES*** *of Federal Financial Reporting*, SFFAC No. 1. The goal of the stewardship **OBJECTIVE** is that the Federal Government "report on the broad outcomes of its actions." Such reporting may provide information that could help report users assess the impact of the Government's operations and investments for the period.[30]

Stewardship Responsibilities

14 A key aspect of the stewardship **OBJECTIVE** requires that Federal reporting provide information that helps users determine (1) whether the Government's financial condition improved or deteriorated over the period and (2) whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.[31]

28 **Split Grants.** Frequently, stewardship elements are financed by grants. In some cases, the grants may have more than one purpose.[32] For such grants, the investment shall be allocated among stewardship elements on the basis of an estimate of the proportionate funding of the various grant **OBJECTIVES**. If allocation is not feasible, the investment shall be reported on the basis of the predominant use of the grant.

Stewardship

The Federal Government's responsibility for the general welfare of the nation in perpetuity. (FASAB Concepts Statement No. 1, ***OBJECTIVES*** *of Federal Financial Reporting*)

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[30] See SFFAC No. 1, pp. 41-42.

[31] Ibid., pp. 42-44.

[32] An example of a grant with a split purpose is a grant issued to a teaching hospital to perform both medical education and medical research.

Comments, Observations, and Issues

Background

Necessarily, I have tried to understand members' comments about SFFAC 1 in the context of my own understanding of it. From my perspective, the pressing **practical** question FASAB initially had to address was how to define the "applicable standards" that would be used to prepare the audited financial statements required by the CFO Act of 1990. The fundamental **conceptual** question FASAB initially confronted (or so it seemed to me) was how the Board should understand the role and task of federal accounting standards.

Rationale for regulation of private sector reporting

Most academic discussion of the rationale for setting accounting standards has been in the context of standards for entities to use when reporting to providers of capital, usually referred to as "the capital market." As summarized in one accounting text:

> Market regulation can be justified on the grounds that it is in the public interest. In this context, two reasons are normally used to defend regulation. One reason is the possibility of a failure in the free market system, referred to as *market failure*, and which results in a suboptimal allocation of resources. Natural monopolies, such as those that occur in the utilities industry, are an example of market failures requiring regulatory intervention to prevent under supply and monopoly pricing. The second reason is the possibility that free markets are contrary to social goals. For example, it can be argued that free markets do not communicate enough information to security markets resulting in managers and other insiders having information that is not available to shareholders. In addition, the information that would be available in unregulated markets might not provide enough comparability among firms. A philosophical justification of the standard-setting process—called *codification*—is based on evolutionary improvement of accounting standards in an open and democratic society.[33]

On the other hand, as the same text notes:

> Several different arguments support the case for unregulated markets. The arguments all relate to the incentives for a firm to report information about itself to owners and to the capital market in general. **Agency theory** explains why incentives exist for voluntary reporting to owners. Wider voluntary reporting to the capital market is explained by **signaling theory** and competitiveness in the capital markets. Finally, it is argued that any information not reported voluntarily could be obtained through private contracting. The arguments supporting unregulated markets are largely inductive in nature. Since we

[33] Harry Wolk, Michael Tearney, and James Dodd, *Accounting Theory: A Conceptual and Institutional Approach*, South-Western College Publishing, 2001, page 104.

> live in a regulated environment, empirical tests of the free market position would be quite difficult. [Page 100.]

One might note that empirical tests of the pro-regulation position are also problematic. Strictly speaking, it is difficult convincingly to prove with empirical evidence that the current regulatory regime is superior to alternatives one can imagine, but in practice few people are calling for *laissez-faire* financial reporting to the capital market.[34] Significantly, both sets of arguments—those for and those against regulation of financial reporting—are presented in the context of reporting to capital markets.

As far as I know, there is no evidence that investors' decisions about whether to buy or hold Treasury securities at a given interest rate are influenced by accounting numbers of the sort traditionally included in the audited government-wide financial statements of the United States or its unaudited "prototype" predecessor. Investors' decisions are more plausibly influenced by current and projected cash flows and economic data reported elsewhere by the Treasury, the Bureau of Economic Statistics, the Bureau of Labor Statistics, the Federal Reserve Board, OMB, CBO, and numerous other Government agencies.

Therefore, most of the literature and debate about regulation of accounting (such as the literature reviewed in chapter 4 of the text just cited) is not, strictly speaking, applicable to a discussion of the role and task of the federal accounting standard setter. The rationale for regulation of financial reporting by publicly-owned companies inherently focuses on external financial reporting to the capital market, where thousands of entities compete for resources provided by many investors making many individual decisions. The federal resource allocation process, by contrast, involves many interest groups competing for resources that are allocated by Congress in a collective decision-making process for the nation.

Some people may argue for federal financial standards by analogy with arguments cited for reporting in the private sector, e.g., between reporting to the capital market and to the "political market," or otherwise find some of the same concepts relevant. Thus, someone using language similar to that cited above might argue that:

> Setting federal accounting standards can be justified on the grounds that it is in the public interest. Absent a FASAB, there is a possibility of a failure in the political system that would result in a suboptimal allocation of resources. Also, absent accounting standards, the political process may produce results that are contrary to social goals. For example, absent FASAB, federal agencies would not communicate enough information to political markets, resulting in bureaucrats and other insiders having information that is not available to all citizens. In

[34] Serious proposals have been made to permit some degree of competition in accounting standards, by allowing companies access to the U.S. capital markets based on financial statements prepared in accordance with International Accounting Standards (IAS) ***or*** FASB GAAP. See, for example, the papers at http://www.aei.org/events/eventID.196,filter./event_detail.asp

addition, the information that would be available absent FASAB might not provide enough comparability among agencies and programs.

On the other hand, some people might find these arguments unconvincing. Among other things, they might assert that:

> While the option of individuals "contracting" for information is not directly relevant because individual voters do not have the power, time, or interest to do this, members of Congress elected by voters do possess considerable ability to demand the production of information in connection with the budgetary and oversight processes. Given freedom of the press and regular elections, the news media and candidates for office serve an "audit" function, calling attention to matters needing attention. Entities like the GAO, CBO, CRS, and IGs function in whole or in part as agents of Congress, and elected and appointed officials have a need to "signal" compliance with laws, as well as managerial efficiency and effectiveness. [35]

Federal rationale

Arguably therefore, the absence of a need to report accounting numbers to capital markets, and the dominance of political rather than capital market forces may lead to differences in the role and task of federal accounting standards setters. For example, FASB apparently has perceived no mandate to be explicitly concerned with the internal record keeping and controls of the entities whose financial reporting FASB regulates, though its members recognize the need for companies to maintain reliable information for external financial reports.

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[35] As this hypothetical language suggests, one can find what are arguably relevant discussions for FASAB in the literature of other disciplines, such as political science, political economics, or public choice theory. There are theories about information asymmetries, with bureaucratic entrepreneurs hording information in order to maximize the budget of their agency or program, "iron triangles," regulatory capture, and other special interest group dynamics (see, for example, *The Logic of Collective Action,* and *The Rise and Decline of Nations* by Mancur Olson). One could argue that these create "market failures" that need corrective action.

On the other hand, there are theories that suggest political markets are exquisitely sensitive to public interest, that political entrepreneurs (candidates) seek and publicize information that the public needs to make decisions (see, for example, *The Logic of Congressional Action* by R. Douglas Arnold, and *The Myth of Democratic Failure: Why Political Institutions Are Efficient*, by Donald A. Wittman.)

As a layman in these fields, I remain unsure what lessons, if any, FASAB should infer from them. An interested agnosticism seems a reasonable response. Consider the CFO Act as an example. If one attempted the same "macro" level of analysis regarding why Congress passed the Act, one might arrive at very different conclusions. One might see it as an enlightened response to perceived "market failures" – or one might see it as a product of lobbying by special interest groups (bureaucrat accountants and AICPA) who stood to gain.

Perhaps due to the problematic nature of such arguments, the FASAB has tended to avail of a "micro" level analysis, focusing on concerns that Congress and others expressed regarding control, accountability, data reliability, and cost information. This difference in understanding FASAB's basic reason for being, in contrast to FASB's, may or may not have implications for FASAB's objectives and for the standards it issues. At the least, however, it seems to suggest that FASAB ought not blindly to adopt concepts and standards developed in a different context for a different purpose.

Congress has, however, asserted a need for society to be concerned with such matters for a variety of reasons, e.g., to permit collection of taxes and enforcement of laws against corruption of public officials. Such factors have influenced the Internal Revenue Code, the Foreign Corrupt Practices Act, and numerous other laws, including the Sarbanes-Oxley response to Enron and other corporate failures. With regard to the Government itself, we have FMFIA, FFMIA, and other laws.

Opinions will differ about the significance for accounting standards setters of this difference between FASB's domain and FASAB. I believe the original FASAB members responded in large part by:

- Looking for the intent of Congress in the words and legislative history of the CFO Act,

- Asserting the need to address ***users' information needs*** and the need for democratic governments to demonstrate ***accountability*** as goals in lieu of reporting to the capital market,

- Acknowledging the intra-Governmental role accounting plays in supporting

    - Coordination and communication among the branches of government and among agencies,

    - Accountability relationships within the Government, and

    - Managerial decisions.

- Drawing upon their own experiences and ideas about the role federal accounting and audited financial statements could play in a cost/beneficial manner.

I believe the original members thought this difference implied, among other things, that FASAB might need to be more concerned than is FASB with internal controls and with the information needs of managers, analysts and other internal users. The FASAB seemed somewhat more concerned than is FASB with what one might call "micro level" functions that accounting can serve within an organization, rather than with the "macro level" issue of resource allocation, though they also recognized the importance of providing information to inform the budgetary process.

There was agreement that users need information from the Government about the efficiency and effectiveness of Governmental activities, and agreement that accounting information could contribute to such information (e.g., with accrual measures of cost of programs and activities, and with measures of the cost-per-unit of output), but the Board did not attempt in SFFAC 1 to define exactly where and how to do that. At least some of the initial members did not conceive of its role exclusively in terms of mandating production of information for outsiders (given the other sources and mandates for reporting), but also in terms of coordinating between and even withing the branches, coordinating between reporting *per se* and operational accounting concerns (systems, SGL), and making cost/benefit decisions regarding what should be audited, reviewed, or subjected to customized assurance procedures, etc. As an example of one early Board members' perspective, I enclose "The Evolution of Private Sector Accounting and its Relationship to the Federal Chief Financial Officers Act," by William Kendig., published in the *Government Accountants Journal*, Fall 1993.

Of course, the original members were influenced by their backgrounds and jobs. Because most of them worked in the Government, perhaps it was natural for them to be attentive to the needs of managers, analysts, and others in the Government. For the same reason, they were aware of laws such as FMFIA that are of concern to federal accountants and auditors, in addition to the CFO Act. Because they were aware of the long-standing dispute between GAO and OMB about the roles and responsibilities of the two branches regarding accounting and financial reporting, it was natural for them to perceive FASAB as an arena for the two branches to reach agreement on what should be done to implement the CFO Act. Because agencies were (and are) required to account and report pursuant to laws, not GAAP, it was natural to focus on legal compliance to a considerable degree. And, just as GAO's *Title 2* included appendices with standards for internal control and for accounting systems, some members may have assumed these matters would be of concern to FASAB.

Some of the initial members referred to the financial transaction processing system, and/or "transaction driven" accounting for transactions of the federal Government *per se,* to distinguish FASAB's domain of concern, as they understood it, from that of economists or other disciplines. At least to some extent they saw the "comparative advantage" of accountants being related to this domain. They did not equate FASAB's domain with bookkeeping, but neither did they equate it with all federal financial reporting; or indeed with some subset of reporting. Rather, I think they saw FASAB's activities taking place within, and contributing to, an extensive framework of activities mandated for various purposes.

Changes since FASAB was created

As FASAB members have pointed out, things have changed. <u>FASAB has successfully served as a forum for resolving accounting issues in a way that the Executive and Legislative branch can accept; so much so that this is now taken for granted</u>. In reflecting on our recent discussions, I've come to believe that this difference in perspective may be significant. Also, most Board members are not Government employees now, and they may tend to think more in terms of compliance with GAAP than with law. In short, it would be only natural for them to think about FASAB's role and task differently.

Congress has also made changes that may affect us. In 1993 the GPRA greatly expanded the modest references to performance reporting in the CFO Act, and set up an elaborate planning and reporting framework for performance reporting. The Reports Consolidation Act of 2000 allowed agencies to combine financial and performance reports, and OMB now requires agencies to do so in performance and accountability reports, which include both the audited financial statements, and the performance report. FASAB has not explicitly discussed this new reporting reality, and whether it has implications for FASAB.

AICPA recognized FASAB as the source of federal GAAP, and AICPA subsequently lost authority to set standards for auditing public companies. (GAO, of course, retains authority to set standards for auditing federal entities and federal funds granted to other entities.)

Issues

From my perspective, it may be premature to pose issues to the Board for decision. However, I have listed a few questions to consider, based on comments I've heard from Board members and others:

1. Should the Board undertake a project on internal control reporting or amend the "systems and control" objective? Comments from some members seem to imply an interest in pursuing one of these options.

2. Should the Board amend SFFAC 1 to reduce the emphasis on reporting to internal users? Comments from some members seem to imply an interest in doing so.

3. Should the Board pursue other projects to address objectives not currently being met, or to make other modifications to SFFAC 1?